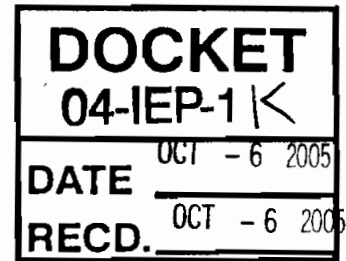




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October 6, 2005



Mr. John L. Geesman, Chairman
Integrated Energy Policy Report Committee
c/o California Energy Commission Dockets Unit
Attn: Docket No. 04 IEP 1K
1516 Ninth Street, MS-4
Sacramento, CA 95814-5512

**RE: 2005 INTEGRATED ENERGY POLICY REPORT
(Docket No. 04 IEP 1K Committee Draft Document Hearings)**

Dear Mr. Geesman:

Kern River appreciates the opportunity to provide comments on the draft *2005 Integrated Energy Policy Report* (Report). As a major interstate pipeline transporting over 1.75 Bcf/day of natural gas to markets in Utah, Nevada and California, Kern River is keenly interested in California's future energy requirements and efforts to ensure that adequate gas supply and energy infrastructure exists. Therefore, Kern River respectfully submits the following recommendations for consideration by the Committee to be included in the Report under Section 7: The Challenges and Possibilities of Natural Gas.

1. **Introduction**

Due to the major basins in North America showing declining reserves, with the exception of Alaska and Northwestern Canada, and increased competition contributing to the uncertainty of gas supply and driving up gas prices, the Report concludes that California should focus on actions within its control, specifically to find alternative sources of natural gas such as Liquefied Natural Gas (LNG). Certainly, LNG may be a viable longer-term addition to the supply mix for California, but increased access to traditional, low cost sources can provide immediate benefits. Gas supply in the Rocky Mountain region (Rockies) provides lower risks and greater certainties in meeting California's objectives of improving natural gas supply diversity and reliability, and providing customers with safe and reasonably-priced natural gas. Access to incremental Rockies production can provide California consumers with the same economic benefit of placing downward pressure on gas prices, as incremental gas supply provided by LNG.

2. **Natural Gas Supplies**

The Report addresses the critical role that natural gas plays in California's energy market and indicates that natural gas supplies are dwindling. While this may be true in many regions, the Report should reflect that the Rockies contain the only domestic gas basins where production is increasing and sustainable reserves are forecast. This region is estimated to have over 38 Tcf of proven reserves¹ and 125 Tcf of potential reserves.² In 2004, production from this region was approximately 8.2 Bcf/day, and recent projections show aggressive growth that could reach 9.3 Bcf/d or higher by 2009.³

3. **Impact of Rising Demand in Neighboring States**

As the Report points out, demand for natural gas in other states affects natural gas supplies to California. However, the Report should be expanded to identify all the sources of increased competition for natural gas, a few of which are discussed below.

According to the 2004 Census Bureau, Nevada and Arizona are the fastest growing regions in the United States, and California will see increased competition for natural gas as it is diverted to serve the residential, commercial and new power generation markets in these states. Although the Report addresses the concern that 8,000 MW of new power generation in Arizona could potentially cause interstate pipeline pressure to drop during periods of high demand, subsequently impacting deliveries to California, it fails to mention that these same plants will also compete with California for up to 1.5 Bcf/d of natural gas supply during peak periods. In addition, competition for gas supply will come from six new gas-fired power plants generating over 3,600 MW in southern Nevada. Therefore, on a peak day over 2 Bcf/d of natural gas previously available to California, will be diverted to serve new power generation markets in Arizona and Nevada.

Competition for gas supply from these states is tempered somewhat by the fact that some of this power generation may serve California. However, the California utilities will feel increased competition for gas supply to serve their core requirements if they continue to re-contract for the vast majority of their gas requirements from the southwest basins and ignore the opportunity to diversify their portfolio to include other gas supply sources like the Rockies. In addition, competition for gas supply out of the southwest basins will intensify even more over time because this region shows flat to declining production in the future.

¹ EIA, U.S. Crude Oil, Natural Gas and Natural Gas Liquids Reserves, 2002 Annual Report.

² National Petroleum Council, Natural Gas Report, Chapter 4, Natural Gas Supply, September 2003.

³ Lippman Consulting, Inc. LCI Forecast Model Update, May 19, 2005.

There are also a vast number of pipeline projects recently constructed or proposed to transport Rockies gas to other east of California markets, a few of which are listed below:

- El Paso's Line 1903 Project will divert up to 250 MMcf/d of Rockies gas and approximately 300 MMcf/d of San Juan Basin gas on El Paso's northern system, to markets in Arizona.
- El Paso's recently constructed Cheyenne Plains pipeline will transport up to 730 MMcf/d of Rockies gas to the Cheyenne Hub to interconnect with pipelines serving Midwest markets.
- El Paso's Continental Connector project proposes to construct a 1,000-mile pipeline to transport up to 1-2 Bcf/d of Rockies gas from its western pipelines to midwestern, eastern and southern markets.
- Kinder Morgan and Sempra Pipelines are also jointly proposing to construct a 1,500-mile pipeline to transport up to 2 Bcf/d of Rockies gas to midwestern and eastern markets.

To effectively compete for Rocky Mountain production, the California utilities and merchant power generators must be willing to enter into long-term natural gas supply and transportation contracts. As stated last week by the Chairman of the Federal Energy Regulatory Commission, Joseph Kelliher, "It is the responsibility of state regulators to require California's reluctant investor-owned utilities to sign long-term contracts so that California's competitive markets can be successful."⁴ The time for California to secure long-term gas supplies from the Rockies is now, before the incremental production from this region is permanently diverted to serve markets east of California.

4. Using Infrastructure to Ensure Adequate Natural Gas Supplies

Kern River agrees that the Energy Commission needs to evaluate the adequacy of California's natural gas infrastructure under extreme conditions (as opposed to the current policy of evaluating capacity on an average annual basis) to avoid costly natural gas curtailments and price spikes when gas is most needed. However, the Report should also note that the current methodology used to evaluate the need for infrastructure expansions must be improved.

In the recent Order Instituting Rulemaking to establish policies and rules to ensure reliable long-term supplies of natural gas to California (R04-01-025), Kern River submitted testimony urging the Public Utilities Commission to require utilities to develop an accurate methodology to evaluate the need for backbone transmission and receipt point capacity expansions in order to maximize gas-on-gas competition. Given the critical role which receipt point capacity plays in gas-on-gas competition, and, in turn, which gas-on-gas competition plays in assuring reasonably priced

⁴ Platts Megawatt Daily, September 28, 2005.

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gas for California consumers, any assessment of the infrastructure adequacy must also include an evaluation of capacity at individual receipt points. Any artificial or physical constraint of natural gas supplies at receipt points restricts California consumers from accessing the lowest-priced gas. If the Commission determines additional infrastructure is needed in order for the utilities to enhance their ability to accept and redeliver new or incremental sources of gas supply, the Commission needs to provide incentives for the utilities to invest in the needed facilities.

In summary, Kern River recommends the Report be expanded to include discussion on the following topics:

- The Rocky Mountain Basin provides proven and sustainable natural gas production and reserves to meet California's goal of securing long-term reliable and diverse natural gas supply.
- California should take action today to secure Rocky Mountain gas supply before it is diverted to east of California markets.
- To effectively compete for Rocky Mountain gas supply, California utilities need to enter into long-term supply and transportation contracts.
- The adequacy of California's natural gas infrastructure needs to be evaluated under extreme conditions, and the current methodology used to evaluate the need for infrastructure expansions must be improved.

If you have any questions regarding these recommendations, please contact me at (801) 937-6270.

Sincerely,

A handwritten signature in blue ink, appearing to read "Gregory T. Snow".

Gregory T. Snow
Manager, Business Development & Planning